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## Trade and geopolitics: should the EU engage with the Eurasian Economic Union?

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### BACKGROUND

The EU and its member states continue to search for solutions to the stalemate in EU-Russia relations resulting from Russia's violation of Ukraine's territorial integrity. To overcome it, various actors and commentators, including the German government, the European External Action Service (EEAS), think-tanks and experts have called for a kind of 'grand bargain'. Its premise is that the EU's engagement with the Eurasian Economic Union (EEU) will pacify Russian sensibilities, thereby (hopefully) leading to peace in Ukraine, which will no longer be forced to choose between two integrating regimes. However, these arguments rest on a range of problematic assumptions about integration dynamics in the eastern neighbourhood. They deserve a closer examination to grasp the implications of the advocated solutions, for both the EU and the eastern neighbours.

As German Foreign Minister Steinmeier put it; "We should ask ourselves ... whether we have overlooked the fact that it is too much for this country to have to choose between Europe and Russia."<sup>1</sup> The underlying logic is that Ukraine was already engaged in a Russia-led integration, and that EU not only ignored this integration process, but disturbed it by imposing its own choices on Kiev. The creation of an overarching, inter-bloc framework would eliminate this dichotomy and allow the Eastern Partnership countries to co-exist with both blocs. At a deeper level, this proposal implicitly but unambiguously acknowledges Russia's "legitimate concerns", about the EU's interference with Russia's "historically emotional ties to Ukraine", as Steinmeier put it, and the alleged harm that would be caused to pre-existing trade links as a result of the EU-Ukraine Association Agreement.

To address Russia's concerns, a trilateral dialogue on the Deep and Comprehensive Free Trade Area (DCFTA) has been set up. The EU aims to find a solution "within the flexibility provided by the EU-Ukraine DCFTA, which, however, will not be amended".<sup>2</sup> Yet some commentators are calling for precisely such a revision; others for an upgrade of the trilateral negotiations to a broader inter-regional dialogue, including the EEU.<sup>3</sup>

Ostensibly, securing peace in Ukraine is a primary motive for these steps. The EEAS's "Issue Paper on Relations with Russia", for example, explores the possibility of offering a dialogue with the EEU as part of a "package deal" to secure Russia's commitment to resolve the Ukraine crisis. Such a dialogue would address the repeated calls of the Russian government and President Vladimir Putin to establish equal relations between the EU and the EEU. Leonard and Krastev have affirmed that "the failure to recognise the opportunity born out of Putin's project for the EEU is at the core of the current crisis ... this is the only project capable of diverting Russia away from the politics of military pressure and nationalistic rhetoric."<sup>4</sup>

These proposals fall short of details. The European Neighbourhood Policy (ENP) review paper of March 2015 encourages input on how to accommodate the "neighbours of our neighbours". The German Chancellor Angela Merkel has spoken of "talks between the Eurasian Union and the EU on trade issues", potentially leading to an inter-bloc free trade agreement and giving credence to the ideas of a common economic space "from Lisbon to Vladivostok".<sup>5</sup> Leonard and Krastev refer to "cooperation and competition between two integration projects, based on different philosophies, but with openness to dual membership and various forms of overlaps and cooperation." These proposals are formulated in an *ad hoc* way, based on premises that are tenuous at best, and neglectful of the reality that has developed in the region for the last two decades. In pursuit of a short-term solution, the broader picture and pre-existing trends are neglected.

## STATE OF PLAY

The 'revisionist' argument makes a number of assumptions about post-Soviet integration in general, and about Ukraine's commitments to Russia. They deserve closer scrutiny in order to fully grasp their implications.

### **'Ukraine has made clear and significant commitments *vis-à-vis* Russia'**

One of the assumptions is that Ukraine has made significant and binding commitments *vis-à-vis* Russia and its integration regime, which constrain Ukraine's integration objectives with the EU. This pre-supposition is questionable.

Since the collapse of the USSR, Ukraine has been, at best, a reluctant participant in the Russia-led integration project, seeking at all times to limit its participation to cooperation rather than integration. Ukraine ensured that the Commonwealth of Independent States (CIS) was weak and poorly institutionalised. When it engaged in other Russia-led projects, it was partially and selectively (an associated member of the 1993 Economic Union, an observer to the 2000 Eurasian Economic Community or within a selective 'pick-and-mix' format with the 2003 Common Economic Space).

Even former President Viktor Yanukovich, the most pro-Russian of Ukraine's leaders, did not deviate from this pattern. In 2011 he refused full membership of the Eurasian Customs Union, and proposed a '3+1' formula, highlighting Ukraine's selective accession to some of the agreements of the Customs Union. In May 2013, Yanukovich only agreed to Ukraine's observer status in the Eurasian structures.

While Ukraine has had extensive trade relations with Russia, its formal commitments were limited to free trade. Even this was difficult to secure within the weak and basic bilateral trade agreement with Russia (the 1993 FTA), which allowed many exemptions from free trade. The exemptions have been renegotiated in annual protocols, giving Russia repeated opportunities to put pressure on Ukraine. Trade relations lacked a stable, legally binding and, most importantly, predictable legal framework. And Ukraine lacked any legal protection from anti-dumping or other discriminatory trade measures imposed by Russia.

The CIS-wide multilateral context provided no remedies to Ukraine's trade difficulties with Russia. The multilateral CIS FTA of 2011 seemed attractive to Ukraine because it contained references to the WTO regime and provided a basic dispute resolution mechanism. But in fact, the 2011 multilateral agreement made little difference: it did not address trade barriers but granted the Eurasian Customs Union a unilateral asymmetric right to punish Ukraine (by reverting to the Most Favoured Nation status) in case of alleged harm (in Annex 6). Now Russia is invoking this Annex to demand the *ex-ante* revision of the EU-Ukraine DCFTA.

For two decades Ukraine's trade relations with Russia have been plagued by trade wars. Moscow made removing various 'trade obstacles' conditional upon Ukraine's participation in Russia-centred integration regimes. Ultimately, Ukraine became dependent on a stronger neighbour which had no qualms in achieving its geopolitical objectives by using trade and energy tools. It was the need for a predictable, stable and rules-based trade regime that underpinned Ukraine's demand for integration into the EU single market.

Ukraine's dependence on Russian energy and Moscow's exploitation of it has shaped their relations since the earliest days of independence. Like trade, energy has been embedded in a bilateral framework subject to short-term renegotiations. Until the 2004 Orange Revolution, Russia provided cheap gas to Ukraine. Since 2005, Ukraine has not been able to get low prices or predictable supplies, despite its willingness to bargain. This does not imply that Ukraine has always been a reliable partner. Yet, having satisfied Russia's demands in the 2010 Kharkiv agreements, Yanukovich ended up paying more for gas than Germany or Italy. Russia has also frequently departed from agreed obligations undertaken to secure political objectives. The EU felt the direct consequences in the gas spats in 2006 and 2009, when Russia cut off its gas supplies to Ukraine.

In sum, Ukraine's trade relations with Russia have been extensive, but they are very weak in legal terms and reflect a strong asymmetric dependence on Russia which has been exploited at will. Thus, prioritising pre-existing relations with Russia over those with the EU is highly debatable. Such an argument is at odds with Ukraine's own past and current preferences: Kiev has favoured FTAs with Russia, and the Association Agreement clearly allows Ukraine to keep its economy open by having multiple FTAs. By objecting to the DCFTA, Russia is seeking to restrict Ukraine's economic integration in the EU, thereby relegating Ukraine to the role of a passive object in international relations. By agreeing to Russia's demands the EU may actually facilitate the achievement of Moscow's hitherto unsuccessful efforts to hamper Ukraine's integration in the EU. Furthermore, it would seem to endorse Russia's strategy in relation to its smaller and vulnerable neighbours, including Moldova and Georgia.<sup>6</sup>

### **'Ukraine was forced to choose'**

The other problematic assumption is that Ukraine had an equal interest in both integration paths, and the EU forced Ukraine to choose between them. In fact, Ukraine's interest in the Eurasian option was strictly circumscribed. Ukrainian elites and experts were sceptical of the advantages of entering the Eurasian regime and acutely aware of its systemic disadvantages, as a range of studies demonstrated.<sup>7</sup> Despite this lack of interest, Russia continued to pressure Ukraine into joining the Customs and then Eurasian Economic Union through full and binding membership.

### **'Russia has identifiable, functional concerns'**

Russia made extensive objections to the DCFTA, which, it alleged, harms its economy and to which it would have to respond by activating Annex 6. The EU responded by agreeing to suspend the DCFTA till the end of 2015 (this decision was taken in a broader context of ceasefire negotiations, the so-called 'Minsk-1'). The negotiations have so far confirmed that Russia's claim of economic harm is a 'non-story', as Michael Emerson put it. Many potential conflicts can be resolved through technical negotiations within the WTO framework, but Russia has shown little interest in doing so. Instead, the trade issues have escalated to the highest political level and become entangled with matters of geopolitics and military security, most recently during the Minsk-2 negotiations. Although rules-based solutions are available, Moscow seems mainly to be concerned about *who sets the rules*.

### **'The EEU is a functional, rule-based integration grouping'**

Key argument in dealing with above challenges is that EU engagement with the EEU would promote the functional compatibility between overlapping regimes, thus diverting attention from a purely geopolitical agenda.<sup>8</sup>

The proposal for the EU to engage with the EEU presupposes the existence of, and compatibility between, overlapping rules-based integration regimes in which geopolitics are absent. This assumption is hardly surprising. The Eurasian integration regime has been a fast-moving, complex and ambitious project, making it difficult for observers to make an informed judgment about the new body. The EEU has undoubtedly made some significant achievements in overcoming previous integration flaws. But the EEU has notable and increasingly apparent weaknesses, in terms of adherence to agreed-upon rules and in the extent to which geopolitics permeates decision-making.

The development of Eurasian integration has been a relentless top-down driven agenda with little attention for implementation or economic functionality. Its evolution from a customs union to a single economic space and economic union over the period of five years has primarily served Russia's geopolitical agenda. Moscow has driven the internal development, often securing its partners' participation via informal bilateral deals on issues beyond the remit of the EEU (energy for Belarus, security for Armenia). At the same time, Russia has had the final say on the drawing of 'red lines' on internal integration (the elimination of export duties, the establishment of a free internal trade in energy). Although numerous improvements in the common legal and institutional framework have been made, the priority has been to have a 'Union' as an international actor. For example, the revision of the Customs Code aimed to consolidate the first integration stage, the Customs Union, is to be completed only in early 2016 – overshadowed by the negotiations of a new treaty on the EEU, which launches a third stage of integration.

Crucially, Russia has monopolised the external agenda of the EEU and its policy towards Ukraine has tested the new integration regime, exposing significant cracks. Russia's ability to use some of its 'tried and tested' instruments, such as the application of anti-dumping duties, seemed constrained by the EEU, as these are now clearly competencies of the EEU as a whole. This means that the other member states have to agree on the adoption of restrictions and sanctions *vis-à-vis* third states, such as Ukraine. Kazakhstan and Belarus refused to join the sanctions against Ukrainian and Western products imposed by Russia in 2014. When confronted with dissenting views within the Eurasian regime, Russia resorted to unilateral actions. Moscow's disregard for legal issues presented other member states with a *fait accompli*. In the ensuing disagreement with Russia, Belarus even moved to re-introduce customs checks. This spiral of unilateral actions has threatened the Customs Union – the biggest achievement of the Eurasian project.

Despite the time and energy invested in the creation of a multilateral structure with supranational elements, the fragile and even tenuous nature of the Customs Union has been laid bare. Russia's disregard for its own multilateral regime results in the 'undoing' of the basic achievements of Eurasian integration. Such an instrumental use of the EEU negates the promise that the EEU is a credible partner (and competitor).

# PROSPECTS

Russia is unlikely to surrender any time soon. This prevents a comprehensive, forward-looking review of EU-Russia relations. The ENP review is unable to provide answers, not only because Russia refused to participate, but because Russia is challenging the very aims of the ENP. Under the circumstances, the creation of the Energy Union is a timely response to a Russia that has threatened to deploy economic instruments in pursuit of geopolitical advantage.

Given all the tensions, there is a natural willingness to focus relations on a seemingly neutral subject – trade – either within the trilateral EU-Russia-Ukraine context or by involving the EEU. However, to do so is to miss the point: Russia's objections are neither technical nor legal. Moscow is challenging the EU's right to pursue its policies on the European continent and the right of independent and sovereign states in Europe to make their own choices.

The Commission's refusal to revise the EU-Ukraine DCFTA is therefore an appropriate response: revising a bilateral agreement under pressure from a third country would set an unfortunate precedent. Such an attempt to placate Russia to 'secure peace' would only increase the growing sense of anxiety in the eastern neighbourhood that the pursuit of democracy, rule of law and economic modernisation via integration with the EU is a security risk too great to take. With trade being part of the bigger geopolitical challenge, the cautious, step-by-step approach *vis-à-vis* the EEU is highly justified.

A new agreement between the EU and Armenia would be a useful pilot run. Such an agreement would test the ability of the EEU member states, which are highly dependent on Russia, to make sovereign decisions on fostering economic and political relations with the EU. This would also allow the partners to identify possible (in)compatibilities between the EU and the EEU before any larger projects are considered.

Given the fault lines within the Eurasian project, engagement with the EEU should move forward with due caution and include a number of conditions with regard to Russia's actions in Ukraine as well as Russia's WTO commitments. It is important that any dialogue includes, apart from Russia, the Eurasian Economic Commission and other EEU member states, if only to prevent Russia from monopolising the EEU's external agenda and avoid the marginalisation of the eastern neighbours inside and outside the Eurasian bloc.

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